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September 10, 2004

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Jonathan G. Katz, Secretary  
U.S. Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549-0609

Re: File No. S7-30-04: Proposed Registration Under the Investment Advisers Act of  
Certain Hedge Fund Advisers

Dear Mr. Katz:

We are writing in response to Release No. IA-2266 (July 20, 2004) (“Proposing Release”), in which the Securities and Exchange Commission (“Commission”) has proposed to require advisers to certain investment pools (“hedge funds”) to register with the Commission under the Investment Advisers Act of 1940, as amended (the “Advisers Act”). We are submitting this comment letter on behalf of one of our investment adviser clients (the “Private Adviser”), which provides investment advice predominantly to various members of a wealthy family (“Family”). We are grateful for this opportunity to comment.

The members of the Family own, directly or indirectly, a majority interest in the Private Adviser. It was established for the principal purpose of providing investment advice to Family members. “Family members,” for this purpose, has the meaning set forth in Section 2(a)(51)(A)(ii) of the Investment Company Act of 1940, as amended (the “Investment Company Act”). As used in this letter, therefore, the term means natural persons who are related as siblings or spouse (including former spouses), or direct lineal descendants by birth or adoption, and spouses of such persons, as well as the estates of such persons, or foundations, charitable organizations, or trusts established by or for the benefit of such persons. The Family members who have an ownership interest in the Private Adviser do not own the Private Adviser in the same proportion as they own the assets managed by the Private Adviser.

The Private Adviser charges fees for its services, primarily as a means to cover the expenses of the organization (such as employees’ compensation and other overhead expenses). The advisory fees provide a means for Family members who benefit from the advisory services to pay for these services. A limited number of non-Family members also use the Private Adviser and pay fees as well. The Private Adviser does not seek to profit from its services. Instead it seeks to maximize the wealth of Family members and others who have entrusted it to manage their assets.

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In managing the assets of Family and non-Family members, the Private Adviser (or an affiliated person of the Private Adviser) has established a few “hedge funds” for the collective investing of those assets. Each fund relies on the exclusion from the definition of investment company contained in Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act of 1940, as amended (the “Investment Company Act”). A significant percentage (well in excess of 50%) of the interests of each of these funds is owned by Family members, but a limited number of non-Family members participate in these funds as well. Each fund is centrally managed, and a participant in each fund is not allowed to opt in or out of the specific investments the fund makes.

In the past, the Private Adviser has relied on Rule 203(b)(3)-1 under the Advisers Act to limit the number of “clients” to fewer than fifteen so that it may claim the exemption from registration under the Advisers Act. Because of the availability of this rule, the Private Adviser has not felt a need to assert or explore with the Commission staff the possibility that it might be excluded from the definition of “investment adviser” in Section 202(a)(11) of the Advisers Act because it might not be providing advice to “others” within the meaning of this section. Because a majority interest in the Private Adviser is owned by Family members and the Private Adviser provides advice predominantly to Family members, it might be argued reasonably that the Private Adviser is providing advice essentially to itself.

We are concerned, however, that under the proposed new registration requirements, the Private Adviser would be required to look through each fund it advises and count as clients, for purposes of the exemption in Section 203(b)(3) of the Advisers Act, each participant in such fund. In such case, the Private Adviser may exceed the fourteen-client limit of Section 203(b)(3) and, if so, would be required to register under the Advisers Act. We question whether registration of the Private Adviser is warranted in these circumstances because a significant portion of the assets the Private Adviser manages consists of assets of Family members who own a majority interest in the Private Adviser.

We believe the new registration requirements should include an exemption from the look-through requirements in such circumstances. An adviser should be permitted to count a fund as a single client where at least a majority of the ownership interests of the fund is owned by persons who have a majority interest in the adviser to the fund and who are related as family, within the meaning of Section 2(a)(51)(A)(ii), including entities owned by these persons as provided in this section, so that it may be said that the adviser in such case is effectively managing its own money. As an alternative, the Commission may consider a combined test, such as one that provides for (1) at least majority ownership in the fund by persons who have a majority interest in the adviser and who are related as family, within the meaning of Section 2(a)(51)(A)(ii) of the Investment Company Act (including entities owned by these persons), and (2) participation in the fund by no more than fourteen other persons.

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Under either of these tests, the Commission would be assured that an insignificant portion of the assets of each fund managed by the Private Adviser would be owned by persons who are not Family members, and that the level of ownership by these persons should not be enough to warrant registration of the Private Adviser. The Commission should feel assured that because of the extensive commonality of interests among fund investors and the Private Adviser in such arrangements, including the fact that the Private Adviser indirectly through its owners has a large amount of capital invested in each fund, the need for registration by requiring that each fund be looked through as contemplated by the proposed requirements, is not present. At the same time, non-Family members investing in a fund would be protected by the antifraud provisions of the Advisers Act because the Private Adviser would be exempted (not excluded) from registration under this Act.

The exemption we recommend for family members is consistent with what appears to be Congress' intent in enacting Section 203(b)(3) of the Advisers Act. As the Commission noted in its Proposing Release, the private adviser exemption appears to reflect Congress' view that there is no federal interest in regulating advisers with only a small number of clients, many of whom are likely to be friends and family members.<sup>1</sup> In that same release, the Commission observed that a similar rationale appears to underlie the exclusion in Section 3(c)(1) of the Investment Company Act; a federal interest does not arise for a fund that is owned by a limited number of investors likely drawn from persons with personal, familial or similar ties.<sup>2</sup>

Our recommended exemption also would not undermine the basis for the Commission's proposal to require the registration of hedge fund advisers. In the Proposing Release, the Commission gave three fundamental reasons for making this proposal: (1) the significant increase in the number of hedge funds in recent years; (2) the increase in hedge fund enforcement cases; and (3) the broadening of hedge fund activities beyond the relatively few wealthy individuals and families who had historically invested in hedge funds. Because our recommended exemption is limited by familial relationships, there is an effective constraint on the extent to which the number of hedge funds relying on such an exemption may grow. In addition, because of the requirement of familial relationships, there is again an effective constraint on the extent to which these funds may grow by seeking participants from a broader segment of the investing public. Finally, because our suggested exemption contemplates very significant participation in a hedge fund by the owners of the fund's adviser, the interests of investors in these funds would be aligned with the interests of the adviser. There is, therefore, not the potential for abuse and conflicts of interests in these funds that exists in other cases.

Our recommendation is also supported by other provisions of the federal securities laws that were enacted or adopted for similar reasons. For example, in determining whether a

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<sup>1</sup> See Proposing Release, n. 17 and accompanying text.

<sup>2</sup> See Proposing Release, n. 17.

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person is a “qualified purchaser” for purposes of investing in a fund relying on Section 3(c)(7) of the Investment Company Act, it is appropriate to consider the “investments” of a company that is owned directly by or for two or more persons that are related as siblings or spouse (including former spouses), or direct lineal descendants by birth or adoption, spouses of such persons, the estates of such persons, or foundation, charitable organizations, or trusts established by or for the benefit of such persons.<sup>3</sup> Congress no doubt believed that because of the significant commonality of interests among persons with these familial relationships, their investments may be aggregated in determining whether they satisfy as a collective unit the investment threshold for treatment as a “qualified purchaser.” There does not appear to be any policy reason that might justify treating funds under the exemption we suggest in this letter any differently.

We would welcome the opportunity to discuss our proposal further with the staff. If the staff sees the need for such discussion, please contact David A. Hearth at (415) 856-7007 or Wendell M. Faria at (202) 508-9574. We very much thank the staff for giving due consideration to our recommendation, as described herein.

Sincerely,

PAUL, HASTINGS, JANOFSKY & WALKER LLP

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<sup>3</sup> See Section 2(a)(51)(A)(ii) of the Investment Company Act.  
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